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SUBJECT: SCENESETTER FOR DIRECTOR OF FOREIGN ASSISTANCE
TOBIAS

¶1. (SBU) Welcome to Peru. Your visit comes just after the six-month mark of President Alan Garcia's government, which sees itself as leading a "moderate" Pacific coast bloc of nations toward regional integration. While President Garcia does not know the U.S. well, he understands that a coincidence of interests -- on economic and commercial issues, counter-terrorism and counter-narcotics, and the disruptive effects of Venezuelan President Hugo Chavez' attempts to export his "Bolivarian" revolution -- require close cooperation with the United States. In his meetings with you, President Garcia is likely to underscore the importance of the bilateral relationship, inquire about the status of Congressional approval of the U.S.-Peru Trade Promotion Agreement and express concern about reported cuts in U.S. assistance levels, particularly in the counter-narcotics area.

Garcia and Latin America

¶2. (SBU) In the regional context, Garcia aspires to lead a loose group of moderate, market-friendly leaders -- some but not all from historically leftist parties -- who are disposed to work closely and cooperatively with the United States. These include the Presidents of Mexico, Colombia, and Chile. He has taken actions that clearly reinforce the moderate centrist elements in South America, including cultivating his friendship with Chilean President Bachelet and inviting Chile to return to the Andean Community. Garcia sees Venezuela's Hugo Chavez as the greatest threat to this vision, and the Government of Peru is working to keep lines of communication open to new leaders in Ecuador and Bolivia in an effort to convince them not to reflexively follow Hugo Chavez' lead. Garcia wants to be a consensus-maker, not a consensus-breaker, and believes that confrontation only favors Chavez. The recent announcement that Peru and Venezuela would send Ambassadors to one another's countries, after an almost one-year hiatus in full diplomatic relations, is an example of this approach.

Peru, Venezuela and the U.S.

¶3. (SBU) Surface developments aside, an array of concrete interests aligns Peru and the United States and divides Peru from Venezuela. Chavez' "Bolivarian" vision for Latin America opposes the free-market model of growth to which Garcia is committed. Chavez' frequent fulminations against

other Latin American leaders, and his pull-out from the Andean Community of Nations (CAN), undermine the positive regional integration (one that engages the United States) Garcia envisions. Garcia shares none of Chavez' sympathy for the FARC, which he sees as Colombian version of Peru's Sendero Luminoso and MRTA. Finally, Chavez' promotion of his Bolivarian ideology and his petro-financed meddling in Peruvian politics, on ample display throughout the 2006 presidential campaign, are profoundly unsettling to a Peruvian President who is trying to satisfy urgent social needs in a responsible fashion.

Hoping for More from the U.S.

14. (SBU) If Garcia clearly understands the economic benefits attached to the Free Trade Agreement (known as the U.S.-Peru Trade Promotion Agreement), in recent meetings with U.S. officials he has often also highlighted its strategic importance. With President Bush in Washington and Senator Reid in Lima, he pointedly noted that democratic governments and free-trading regimes need to demonstrate that democracy and free trade are better for everyone in the region, including the poor, than are the populist, autocratic, "closed economy" alternatives -- implying that PTPA passage would be pivotal in this connection. Garcia and his APRA Party voted for the PTPA's ratification last June. Now, with the fate of the agreement unclear, the President is concerned about the consequences to his personal credibility and the standing of his government if the U.S. Congress does not approve it.

15. (SBU) Similarly, Garcia is likely to express his disappointment regarding the decline in U.S. assistance

levels to Peru, particularly for counter-narcotics. This concern is rooted in recent press reports surrounding President Bush's 2008 budget submission. Garcia and his Foreign Minister may question whether the U.S. budget allocations sufficiently distinguish between their friendly and cooperative government, on the one hand, and the more confrontational administrations of Morales in Bolivia and Correa in Ecuador, on the other. They are also concerned that the timing of planned reductions in U.S. assistance will undercut efforts to implement their newly approved National Anti-Drug Strategy, that significantly increased GOP expenditures towards combating illicit coca in collaboration with donor programs.

16. (SBU) While Peru has a decade-long history of progress on counternarcotics, there has been some worrisome regression more recently. Ten years ago, Peru was the world's number one producer of cocaine. The Fujimori government's disruption of the narco smuggling air route between Peru and Colombia caused coca prices to crash and production to be rolled back. In recent years, cultivation and prices have begun to rise, and Garcia stated recently that the GOP had to put more of its own money into the fight against illegal narcotics. The new, and long-awaited, 2007-2011 National Anti-Drug Strategy, unveiled by the Peruvian government at the end of 2006, indeed provides a specific, rational budget for counter narcotics efforts -- a first. The GOP has also restarted eradication and interdiction operations in the main coca source zones. In addition to eradication and interdiction efforts, the GOP's new anti-drug strategy focuses on prevention programs and alternative development. With respect to prevention, the strategy highlights increasing drug consumption among Peruvian youth and calls on Peruvians to recognize that narco trafficking is not only a problem for the rich consumer nations but also destroys the fabric of Peruvian society.

The Domestic Front

17. (SBU) On the domestic front, Garcia faces a number of challenges but also has significant cards to play. Garcia's key challenge will be to strike a balance between tending to urgent social needs and preserving macroeconomic stability.

His government must produce concrete results for the significant swath of voters -- almost 50% -- who chose radical nationalist and Hugo Chavez ally Ollanta Humala in the 2006 general elections, and stem the fragmentation evidenced in the November regional and municipal elections (in which traditional parties, including the ruling APRA, lost big). Peru's disenfranchised, concentrated in the southern highlands and the Amazonian lowlands, believe that five years of economic growth have brought them little, and they will be holding President Garcia to his promise of quick, decisive and meaningful action to improve their lives.

18. (SBU) President Garcia has shown that he understands the urgency of the challenge. And at least on a symbolic level, he has responded quickly, implementing a series of austerity measures, including cutting the salaries and benefits of public officials and reducing the foreign travel of high-level government representatives. (He himself flew economy class to the United States, accompanied only by the Foreign Minister, for his meeting with President Bush late last year.) His administration has also proven quick and dexterous in responding to social conflicts in the regions. He also announced an "investment shock" in sectors like schooling and water delivery. But as the honeymoon bloom wears off and the workmanlike phase begins, some observers are beginning to look for evidence that the government's plans are more than promises and that the hard slow slog of implementation has begun -- and finding mixed results.

Enter the Millennium Challenge Corporation

19. (SBU) The Garcia administration's recently submitted proposal to the Millennium Challenge Corporation (MCC) for funding under the threshold program underscores its recognition of the nature of the development challenges it faces and the need to show concrete results. The GOP's

overall strategy, as reflected in its MCC proposal, is to sustain high levels of economic growth, while addressing Peru's long-standing issues of inequality. The GOP proposes to do this by improving the quality of the institutions of government (through implementing an anti-corruption campaign and reforming inefficient agencies) and expanding the access to and quality of basic services (such as immunization coverage and education). The GOP is seeking MCC threshold funding specifically for its anti-corruption efforts and delivery of immunization services to underserved areas of the country.

It IS the Economy

110. (U) In his recent "State of the Republic"-type address, Garcia focused almost exclusively on the economy, and said his number one focus was growth. This is no surprise, given the booming numbers Garcia inherited from his predecessor Alejandro Toledo: five years of sustained economic expansion, 7% growth in 2006 and forecasts of over 8% for this year. For their part, exports have more than tripled over the past five years (partly thanks to high metal prices). Growth has cut the poverty rate from 54 percent in 2001 to 48 percent today. Extreme poverty -- those living on less than \$1 per day -- declined from 24 percent to 18 percent during the same period.

111. (U) Peru's growth has been private-sector generated, export-led, and largely powered by increased trade with the United States (thanks to the Andean Trade Preferences Act--APTDEA). The United States is Peru's top export destination, absorbing 25-30% of the country's exports. From 2001 to 2006, Peru's exports to the U.S. tripled to USD 5.4 billion. Garcia is committed to broad trade liberalization while PTPA approval is its top priority. His government also seeks to strengthen its ties with neighboring Latin American countries. Peru expanded the Economic Complementation Agreement with Chile in 2006, and is pursuing trade deals with Mexico, Canada, the EU and several Southeast Asian countries. Trade with China too is significant and

increasing. Finally, Peru is preparing to host the Asia Pacific Economic Cooperation (APEC) summit in 2008

Tactical Political Skills Evident...

¶12. (SBU) Garcia is an acknowledged master of political tactics, deft in seizing the policy initiative and focused on keeping his rivals -- within the government, congress and his own APRA party -- on their heels. This is in sharp contrast to Toledo's political inexperience, and has lent Peru a surface political stability it had not seen for several years. It has also helped the President maintain solid public support, with poll numbers still well over 50%. In some cases, Garcia has done this by resorting to gestures that, while unlikely to have any legislative follow-through, echo favorably with the public. Following a recent controversial Inter-American Court of Human Rights (IACHR) decision demanding that the state indemnify the families of terrorists who were killed in a 1992 prison uprising, Garcia reiterated his public call for the death penalty for terrorists (aware that 85% of Peruvians agreed but that Congress had already blocked the measure) and threatened to pull Peru out of the regional court (later backing away from this threat).

But Strategic Intentions Unclear

¶13. (SBU) While few observers doubt Garcia's political skills, some wonder whether the apparent short-term tactical focus might undermine the government's ability to address the country's longer-term structural challenges. Critics complain that his government's signature programs -- "Sierra Exportadora" (Exporting Sierra, which is intended to connect small rural producers to national and international markets), "Agua Para Todos" (Water for Everyone, which is aimed at bringing clean water to poor urban and rural communities) and Decentralization (which is meant to transfer state functions, authority and resources to regional and municipal governments) -- are not being implemented with the proper dispatch. For example, the state comptroller recently

testified to Congress that less than 10% of the monies dedicated to decentralization had been transferred to regions.

¶14. (SBU) To seize back the policy initiative, Garcia recently launched a plan for a radical reform of the state. An initial draft of the plan calls for significantly reducing bureaucratic duplication, streamlining employment in the executive branch and re-focusing the state's energies away from promoting economic and social progress to regulating the activities of the private sector. To push the idea, the President hosted a meeting of the country's political leaders to listen to their views and get their buy-in. In a positive scenario, this comprehensive state reform project could build on the government's early success in curtailing the powers of the radical teacher's union (as a first step toward fixing the broken education system) and in refocusing Peru's defense forces toward transnational threats such as narco-trafficking and terrorism. Still, people will increasingly be looking for proof in the pudding.

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